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Looking ahead: What you need to know Winter 2017

The 100 Group briefing

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The 100 Group briefing

Dear members of The 100 Group,

Welcome to the first edition of the 100 Group briefing for 2017.

With only 2 weeks to go till Christmas and the end of the year close behind, this edition of the 100 Group briefing aims to sum up developments to December and offer advice on issues you should be aware of for the return to work in the new year.

There have been a number of releases from the FRC, including a letter providing guidance to preparers of annual reports which may provide a useful checklist to Group members about to enter reporting season. The FRC has also released its annual review of corporate reporting, with the underlying message that the quality of corporate reporting is generally good. Group members may wish to review the more detailed information on the use of APMs – this is a topic that we've seen rise to the top of various regulatory agendas this year.

In 2017, we predict significant developments in UK corporate governance. The BEIS Committee has already called for evidence on corporate governance and we've just seen a green paper published on the same topic. You can read more about what might change in this edition.

We've set out in the Executive summary the other topics included in this edition. I hope you find the briefing useful – please do let me know what you'd like to see more of and how we can improve the publication.

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Looking ahead

The 100 Group briefing, *Looking ahead*, is a quarterly briefing commissioned by the 100 Group of Finance Directors. Its aim is to brief the group on key developments in the capital markets and proposed changes in regulation and standards that might require response, lobbying, or which are important for general awareness.

For further information, please contact Gilly Lord.

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Key: M – Monitor   R – Respond/React   L – Lobby

Reporting

FRC issues advice to preparers

The FRC has released a letter containing guidance to preparers of annual reports of around 1,200 large and smaller-listed companies. PwC's Peter Hogarth looks at the key issues highlighted.

The FRC has issued a letter addressed to audit committee chairs and finance directors offering the FRC's perspectives on aspects of annual reports on which companies should focus during the next annual reporting season.

In the letter the FRC discussed many of the matters raised in its Annual Review of Corporate Reporting (see below). With a particular focus on the strategic report, they advised that companies should report in a user-friendly, clear and concise manner. Furthermore, in an era where, for example, cyber-risk, climate change and Brexit pose economic, social and environmental uncertainty, the FRC encouraged companies to consider a broad range of factors when determining principal risks and uncertainties facing the business and performing their analysis for the viability statement.

The FRC also identified some key areas and what investors expect from company reports:

- The relationship between IFRS or UK GAAP measures and any alternative performance measures used must be clearly explained (see below).
- Business model reporting should provide clarity in explanations of how the company makes money and what differentiates it from its peers.
- A clear link between the business model and the revenue recognition policies should be disclosed.
- Dividend disclosures should explain how dividend policies operate in practice and how these policies may be impacted by risks and capital management decisions facing the company.

The FRC's letter provides a useful checklist that Group members might find helpful when reviewing their next annual report.

Annual Review of Corporate Reporting

In late October, the FRC released its Annual Review of Corporate Reporting 2015/16. PwC's Peter Hogarth looks at the findings.

The FRC's Annual Review of Corporate Reporting provides the regulator's assessment of the quality of corporate reporting in the UK based on its monitoring work for the year to 31 March 2016. Of the 192 companies whose reports were reviewed, the FRC raised queries with approximately one third. Most companies concerned have agreed actions to resolve the matters satisfactorily, primarily through their future reporting.

Overall, the FRC considers that the quality of UK reporting, particularly by larger public companies, is generally good. But as always, the FRC highlights some areas where companies 'could do better' (these include areas such as accounting policies,

judgements and estimates, pensions and taxation). However, while acknowledging that the introduction of the strategic report a few years ago has improved the quality of narrative reporting, the report highlights calls for companies to be more balanced.

The FRC questions whether companies have lost sight of the legal requirement for strategic reports to provide a 'comprehensive' analysis of the figures reported in the accounts. Failure to acknowledge when things have not gone so well, excessive use of underlying profit figures or inappropriate use of alternative performance measures (APMs) are, in the FRC's opinion, found too often and erode trust and undermine the quality of corporate reporting.

The FRC stresses that it is not averse to the use of APMs. And there is plenty of evidence that investors and other users find them useful too. But in the Annual Review and in a thematic study of APMs issued in November, the FRC has made it clear that it will challenge companies where:

- good explanations of APMs and their calculation are not provided
- items are described as non-recurring where it appears that this is not the case
- there is no discussion of the actual IFRS results or the adjustments made to them
- the IFRS results are not highlighted early in the narrative.

The FRC is not alone in increasing its focus on APMs; it is an area of interest to the US SEC too. Against this backdrop, and with the European Securities and Markets Authority (ESMA) Guidelines on APMs now in effect, this is an opportune time for companies to take a closer look at how and what they report.

Group members may wish to appraise their own use of APMs and whether they are presented in a manner consistent with the ESMA Guidelines and FRC suggestions.

Changes to Corporate Reporting Review procedures

The FRC has issued a consultation on its Conduct Committee's operating procedures for reviewing company reports and accounts. PwC's Peter Hogarth looks at what this may mean for companies.

Also in October, the Financial Reporting Council (FRC) issued a consultation on its Corporate Reporting Review's operating procedures.

These operating procedures have two main purposes: to demonstrate that the FRC has satisfactory procedures in place to carry out its statutory functions, and to provide transparency about the review process to those companies whose reports may be reviewed, as well as to complainants, investors, and the public generally.

Earlier this year, changes were made to the FRC's governance and executive structures which resulted in minor amendments to the operating procedures; these were published and took effect on 1 April 2016. It was indicated at the time that a further review of the operating procedures would take place over the coming months and would, in all likelihood, result in more extensive changes being proposed which would be the subject of public consultation. This is the resulting consultation. It invites feedback from interested parties to changes proposed in areas including:

- the increased role of FRC staff during the early stage of the review process
- identification of reports and accounts reviewed
- disclosure of information.

It is the increased transparency of the review process that is likely to be of most interest. All companies will be informed when their accounts have been reviewed, which will result in many receiving 'no issue letters' pointing out that there are no substantive issues that the FRC wishes to raise. And flowing from the revised Guidance for Audit Committees issued last April, companies are in turn expected to be more transparent in their external reporting regarding discussion of interaction, if any, with the FRC.

Ultimately, the FRC plans to publish the names of all companies reviewed, but only after cases are closed and the companies in question have had the opportunity to make their own disclosure.

Should Group members wish to respond to the consultation, responses are required by 4 January 2017.

FRC Reporting Lab – key attributes for better business model reporting

Business model reporting became mandatory for quoted public companies in 2013, yet 3 years later our engagement with them suggests many continue to struggle to articulate their business model. PwC's Sarah Allen looks at how a new report from the FRC could prompt better business model reporting.

The FRC Reporting Lab has published its report into Business Model Reporting. This report reflects the views of companies, investors and investment and analyst organisations, and forms part of the FRC's Clear & Concise reporting initiative. So what does the report say and what does it mean for companies?

The importance of business model disclosures

While practice has been improving, the Lab's report found that many companies believe investors already know their business model, are not interested in the disclosure, and as a result treat it merely as a compliance exercise. It's therefore interesting to note that the Lab's research confirmed that business model information is fundamental to investors' analysis and understanding of a company and that in fact investors want more detail than is currently being provided by most companies.

The report identifies several advantages of comprehensive business model disclosure, including enabling the company to articulate their business model rather than allowing others to develop their own definition, and demonstrating the board's clear understanding of their business and so increasing investors' trust in the quality of management.

Current practices in business model reporting

To accompany the launch of the Lab's report, PwC performed its own review into the quality of business model reporting in the FTSE 350. Our research found that business model disclosures:

- continue to improve and are becoming more comprehensive, but
- are often generic, referring to competitive advantage or differentiating factors without being clear what they actually are, and

- presentation often remains isolated from the other key components of the annual report such as market insights, strategy, risks and KPIs.

So, if disclosures are improving but investors still want more, what would effective business model disclosures look like?

Attributes of good business model disclosure

In response to this question the FRC Lab identified the following key attributes of good business model disclosure:

- An obvious and natural linkage throughout the report, from the business model to remuneration and the dividend policy.
- Clarity about what the entity does and why it does it, including the position of the company in the value chain.
- An understanding of how the entity generates value and preserves it over the longer term, i.e. what the key revenue and profit drivers are and what assets/ liabilities support value creation.
- An explanation of what differentiates the company from its peers.
- A high-level understanding of how the entity is structured, including key divisions and segments, and the markets in which it operates.
- A broad understanding of the nature of the relationships, resources and other inputs to the business model.

Business model presentation

The Lab found that nearly all investors believe business models should be disclosed towards the front of the strategic report, many preferring it to be the first item. The language used should be plain, clear, concise and factual, and most investors believe a combination of narrative and infographics/tables/charts is the best way to communicate a business model. When a clear business model has been developed, investors only expect changes to the disclosure when the underlying elements of the business model change. Such changes should be clearly identified and any known upcoming changes flagged.

Creating business model disclosure that is truly comprehensive undoubtedly takes time and effort to get right. However, the FRC Lab's report and our own recently published research on business models should provide Group members with a useful basis to challenge existing disclosures. Group members who report a clearly defined and dynamic business model which demonstrates how they respond to an increasingly disruptive environment will be rewarded by investors.

Corporate governance

BEIS request for evidence on corporate governance

PwC's Joan Medland and Kate Elsdon cover developments relating to the UK Corporate Governance Inquiry.

Following commitments made in July this year by Prime Minister Theresa May to 'rebuild trust in corporate Britain', a Corporate Governance Inquiry was established through the parliamentary Business, Energy and Industrial Strategy Committee (BEIS) (formerly, the Business, Innovation, and Skills Committee), focussing on Directors' duties, executive pay and board composition/diversity. A series of questions were presented with calls for evidence. The BEIS department has also released a Green Paper on corporate governance – you can read more on this later in this section.

The questions in the call for evidence probed into three broad areas:

- Whether the current legislation around directors' duties is sufficiently clear and appropriately encourages directors to make business decisions that balance the interests of stakeholders, employees and the long-term success of the company – and whether those decisions are adequately scrutinised by independent challenge.
- Whether executive pay is excessive, particularly in the context of corporate performance, and the means by which the Government should act if it is.
- What more could, or should, be done to achieve more diverse boards (including worker representation and gender balance in executive positions).

To formulate our response, PwC convened groups of expert practitioners from across our organisation drawing upon deep subject matter knowledge and experience in each of the fields under scrutiny. The submission is available online in more detail, however in summary, PwC believes that the UK has a vibrant, effective and attractive corporate governance framework and that the basis of this framework, being 'comply or explain' rather than legislation, is fundamental to this success. Furthermore we are of the view that unitary boards promote collective responsibility, allowing boards to take stakeholder interests into account without undue influence or giving favour to any one special interest group, and should be preserved.

The articulation of a more consistent and transparent approach to how companies balance shareholder and stakeholder interests, on what constitutes the long-term success of a business, and the development of appropriate metrics for managing and reporting success would be welcomed. We believe that companies should also improve upon the communication of business purpose throughout employee, stakeholder and wider communities. Additionally, we believe there is a need for the consolidation or formalisation of existing guidance for certain private companies (such as the Institute of Directors' "Corporate Governance Guidance and Principles for Unlisted Companies").

Implications

Directors' Duties

We believe that director's duties are clearly codified by the Companies Act 2006, but there is a lack in general understanding of, and transparency around, how directors are applying these duties. Where corporate reporting has been transparent this has led to significant improvements in corporate behaviour as it has allowed companies to be held to account by the wider stakeholder group (including shareholders). However we would caution against too much special interest reporting.

Executive Pay

Companies should be allowed the flexibility to determine their reward structures and attract the talent needed to drive business strategy. Furthermore, measures introduced three years ago are showing signs of success and require more time to embed. Further Government intervention could make the UK uncompetitive in a global market, and direct action would only be justified if there were a demonstrable failure in governance or market forces that determine pay (however this is not supported by evidence).

Should the Government need to respond to the significant public disquiet about inequality of pay, we recommend the Financial Reporting Council considers introducing a requirement for company boards to publish a Fair Pay Charter which sets out how the company's policy on pay for the wider workforce differs from that for executives, as well as the target positioning of both executive and employee pay against the market.

Composition of Boards

It is crucial for boards to have the right balance of skills, knowledge and experience as well as gender, race, and other forms of diversity. The exact nature of skills and experience will, of course, differ depending on the company's strategy and purpose; this alignment is key so that it does not become 'tokenism'.

It's irrefutable that board composition should also strive to reflect the stakeholders (including customers and employees) it serves in order to understand the needs of those groups and, in doing so, achieve the business' purpose. We recommend that BEIS considers providing focus on what a truly effective board composition consists of, based on a broader diversity of skills and experience and aligned to the cultural climate and strategic market needs of the business, rather than on racial, gender, or other diversity quotas. To satisfy the need for diversity at board level, we strongly recommend that companies prioritise more effective management of a talent pipeline at all levels of the organisation, thus developing and broadening the pool of qualified, effective directors available in the market.

The findings of this Corporate Governance Enquiry will have no doubt influenced the BEIS Green Paper on corporate governance reform. The need for reform was recently reiterated by Theresa May speaking at the CBI. Group members should monitor further developments in this area.

BEIS Select Committee inquiry into corporate governance and the FRC's response

The current BEIS Select Committee inquiry raises a number of fundamental questions about the UK's corporate governance framework. The tone of the FRC's response to the Committee's call for evidence is significant, says PwC's John Patterson.

With corporate governance receiving renewed political interest due to the BEIS Select Committee's inquiry, the FRC could be seen to find it challenging, as in their *Strategy for 2016-19* they indicated that they would avoid making further changes to the UK Corporate Governance Code ('the Code') once the changes in hand were complete. Their plan was to focus on some of the 'softer' aspects of governance, in particular succession planning and the broad area of culture & values, through the Culture Coalition. These remain important issues, and corporate culture is closely connected to the subject matter of the inquiry, but the renewed political interest changes the whole context for the FRC's work.

The FRC's response to the inquiry

It seems clear now that companies should expect changes to the Code prior to 2019. Significantly, the tone of the FRC's letter in response to the Select Committee inquiry is not defensive; rather, it recognises many of the issues and indicates a willingness to act across a broad front.

Main recommendations

The FRC's suggested actions include the following. Those that relate to reporting are indicated so companies can consider their existing governance reporting in light of them.

1. Increase the focus of boards on s.172 of the Companies Act, which makes directors responsible for taking account of a range of stakeholder and other interests in addition to the interests of shareholders when defining success for a company. The FRC suggests that this could be done by enhancing the reporting of how the company allocates funds between pensions, dividends, directors' remuneration, investment and capital investment, through the Code and FRC Guidance on the strategic report. Another reporting recommendation proposes that the Code be amended to strengthen the disclosure of board decisions "in order that shareholders and wider stakeholders might scrutinise them and challenge more effectively where necessary".

2. Amend the Code to encourage boards to strike a better balance between the interests of shareholders and current and former employees. This could be through "either … assigning responsibility to a non-executive director or creating other methods of stakeholder engagement such as stakeholder advisory committees".

3. Develop a code or guidance for larger private companies.

4. Encourage the Government to review the enforcement framework to hold directors and others in senior positions to account when they fail in their responsibilities.

5. Consider various measures related to executive pay including amendments to the Code to widen the remit of the remuneration committee over the pay and conditions of the workforce; enhance reporting on the link between remuneration structure and strategy; strengthen the expectations around the use of discretion; and explore how companies' responses to significant votes against the remuneration report can be enhanced. The FRC also recommends that the Government should establish an inquiry "into the issues raised by the quantum, growth, disparity and performance-linkage of rewards".

6. Consult on amending the Code to take account of the work of the Hampton-Alexander and Sir John Parker reviews on diversity.

The FRC also notes that it "is currently assessing the way in which it monitors the quality of UK Corporate Governance Code reporting, including the option of more direct contact with companies where explanations are not adequate, and publicising good and poor practice".

Preserving what's good

The overall aim of the FRC's response is to help ensure that "trust and investment" are maintained in a "period of economic uncertainty", and to deal with the public perception that "corporate scandals, whatever the cause, go unpunished, that poor executive performance often still earns high rewards and that shareholders benefit from excessive dividends".

Although its recommendations would entail some radical changes, the FRC is clear that UK corporate governance is still highly respected, both domestically and internationally. It therefore remains strong in its commitment to the unitary board and a principles-based comply-or-explain framework.

The Select Committee inquiry was followed by the publication of the Green Paper (see below) and there will be further consultation by the Government, with the FRC no doubt positioning itself to influence the direction of that process. Its response to the Committee certainly takes a notably tough stance on areas such as the need to hold directors to account more effectively and on executive pay.

The Prime Minister's speech at the CBI Conference in November ruled out "mandating works councils, or the direct appointment of workers or trade union representatives on boards". This could signal a less radical approach than was suggested during the leadership campaign, but the direction has been set and Group members might be well advised to think carefully about their employee engagement and how they report on it, as well as looking at how they stack up in the other areas of reporting that the FRC is proposing to focus on.

BEIS Green Paper on corporate governance reform

In late November the Department for Business, Energy and Industrial Strategy ("BEIS") issued a Green Paper on Corporate Governance Reform. PwC's Margaret Cassidy looks at what was included.

The publication of the Green paper follows on from the Inquiry by the BEIS Select Committee discussed earlier in this document. The paper covers directors' duties, executive pay and composition of boards. Options presented are wide ranging and it

appears that Government are genuinely seeking views on some quite different approaches.

Executive pay

A range of options are presented aimed at:

- strengthening shareholder voting rights
- encouraging greater shareholder engagement around executive pay
- strengthening the role of remuneration committees
- further improving transparency on executive pay
- improving the effectiveness of long-term pay incentives.

Options include:

- an annual shareholder binding vote on elements of pay, stronger consequences for loss of an annual advisory vote and more frequent binding votes on policy
- company policy to include upper limit on total pay, a pay ratio requirement (for example, CEO:median employee pay) and shareholder committees to scrutinise pay and other matters;
- remuneration committees to consult in advance with workers and shareholders on pay policy, enhanced disclosure of bonus targets and a proposal that the chairman of the remuneration committee should have a year's experience of serving as a member of a remuneration committee prior to appointment as chairman.

Strengthening the employee, customer and wider stakeholder voice

The paper recognises the existing legal duty of directors to create successful businesses for the benefit of shareholders, whilst having regard to a range of other interests. However, the Government wants to raise the profile of companies' compliance with this duty.

Proposals include establishment of advisory panels and designated non-executive directors with specific responsibilities to engage with the workforce. The option to appoint individual stakeholder representatives (such as workers) to company boards is still presented in the paper, but it is acknowledged that it is unlikely that this will work for all companies, and therefore it will not be mandated. Group members will recall that PM Theresa May forewarned us of this position change in her recent speech at the CBI conference.

Stronger reporting requirements are also proposed on how companies give due consideration to different stakeholder interests.

Corporate Governance in the UK's largest privately-held businesses

The paper asks whether the UK's largest privately-held companies, where they are similar in size or economic significance to public companies, should be expected to meet higher minimum standards of corporate governance and reporting. If required, options include extending the UK Corporate Governance Code, or developing a new code tailored specifically to large privately-held businesses.

Group members should consider responding to the Green Paper, given that whatever the outcome, we are likely to see significant changes in the governance environment. The consultation period ends on 17 February 2017 and it's anticipated that the Government response to the consultation will be published in early Spring 2017 with a White Paper setting out more detailed proposals issued in late Spring 2017. The timing of the impact of any reforms will depend on the final proposals and the extent they can be delivered by non-legislative means.

Direct and indirect tax

HMRC given power to require companies to publish country-by-country tax information

The Finance Act 2016 includes a provision that could result in companies being required to publish a "country-by-country report". PwC's Phil Greenfield looks at the implications for companies.

The provision could result in companies being required to publish a "country-by-country report" showing their profits, taxes paid and other financial information for the countries in which they operate. This is the information which the company has to supply to HMRC as a result of base erosion and profit shifting (BEPS) to potentially be shared with tax administrations in other countries. The requirement takes the form of an addition to the other information which the company will have to make public in relation to its group tax strategy under the Finance Act.

The requirement will not come into effect unless a specific regulation is adopted. The Government has given a commitment not to introduce such a regulation without international consensus (without defining what that means). If such consensus was reached then regulations could be introduced relatively quickly, without waiting for the subsequent Finance Bill.

Group members should keep an eye on developments. There are countries that are strongly against making country-by-country BEPS information public. It is uncertain whether the UK would consider whether there was sufficient international consensus without the inclusion of the US, for example.

FRC thematic review welcomes improved transparency of tax reporting

The FRC has published a report on the results of its thematic review on certain aspects of tax reporting in company annual reports and accounts. PwC's Janet Kerr looks at the reasoning behind it and what the FRC found.

In late October the Financial Reporting Council (FRC) issued the results of a thematic review undertaken by its Corporate Reporting Review (CRR) function on certain aspects of tax reporting in company annual reports and accounts.

Thematic reviews supplement the FRC's monitoring of company reports and accounts for compliance with the Companies Act 2006, applicable accounting standards and other reporting requirements. They enable a focus on topical areas of corporate reporting, with the aim of these reviews being to identify examples of good practice reporting and areas where improvements can be made.

The CRR looked at strategic reports, the effective tax rate reconciliation and disclosure of uncertain tax provisions, with the objective of this particular review being to encourage more transparent reporting of:

- the relationship between tax charges and accounting profit
- factors that could affect that future relationship.

Supporting its *Corporate Reporting Thematic Review: Tax disclosures*, CRR pre-informed 33 FTSE 350 companies that the tax disclosures in their next annual reports and accounts would be reviewed.

The FRC found that most companies whose tax disclosures were reviewed proactively improved them, particularly in respect of tax disclosures included in strategic reports and the effective tax rate reconciliations. This is interesting evidence that the new CRRT approach of “pre-informing” companies of a review may be beneficial.

However, the FRC also commented that there was still scope for companies to articulate better how they account for tax judgements and uncertainties, and they expressed disappointment that no FTSE 100 company stood out as a role model in their tax reporting. The FRC explained that good disclosures would identify the specific nature of the assumption or uncertainty, quantify the carrying amount subject to uncertainty and highlight that these were subject to material change in the following year. Good practice would also include the provision of sensitivity analysis or a range of possible outcomes to provide users with a better understanding of the issue.

The introduction of new IFRS requirements in this area, expected shortly, presents another catalyst for companies to consider their approach to tax reporting. The FRC will continue to challenge companies on their tax reporting, so understanding developments in reporting, both mandatory and voluntary, and how your disclosures compare to others is key. The FRC will also be carrying out audit monitoring activities in this area in 2016/17, so you should expect auditors to focus on your tax disclosures.

Group members should review the FRC’s report and its findings and compare this to their tax disclosures to identify areas for improvement. They may also wish to perform work to enhance disclosures on uncertain tax provisions, and consider how tax disclosures may link to the publication of tax strategies.

Assurance

IAASB and IESBA amend standards to enhance auditors' and professional accountants' focus on non-compliance with laws and regulations

PwC's Diana Hillier looks at the IAASB's ISA 250 and how it relates to NOCLAR.

In October the International Auditing and Assurance Standards Board (IAASB) released International Standard on Auditing (ISA) 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*, and conforming amendments to other International Standards, which respond to the new requirements released recently by the International Ethics Standards Board for Accountants (IESBA) in their *Code of Ethics for Professional Accountants addressing non-compliance with laws and regulations (NOCLAR*).

What is NOCLAR?

Responding to Non-compliance with Laws and Regulations is a new international ethics standard that applies not only to auditors but also to other professional accountants (PAs). It sets out a first-of-its-kind framework to guide PAs in what actions to take in the public interest when they become aware of a potential illegal act, known as non-compliance with laws and regulations (or NOCLAR), committed by a client or employer. Developed after more than six years of extensive consultation and multi-stakeholder input, the standard positions the accountancy profession to play a greater role in the global fight against NOCLAR, such as financial fraud, money laundering, and corruption.

The new IESBA standard applies to all categories of professional accountants, including auditors, other professional accountants in public practice, and professional accountants in organisations, including those in businesses, Government, education, and the not-for-profit sector. It responds to the view that there was a lack of guidance to help PAs in working out how best to respond to a potential NOCLAR, a situation that may often be difficult and stressful.

It is the first time accountants have been permitted to set aside the duty of confidentiality under the IESBA Code of Ethics for Professional Accountants in order to disclose NOCLAR to appropriate public authorities in certain circumstances. The standard was developed in response to the perception that the duty of confidentiality in the Code acts as a barrier to the disclosure by PAs of potential NOCLAR to public authorities in the appropriate circumstances.

In addition to introducing more direction to auditors on what to do when a possible NOCLAR comes to their attention (including in group audit situations), it also places renewed emphasis on the role of senior-level accountants in business in promoting a culture of compliance with laws and regulations and prevention of non-compliance within their organisations. It is hoped that the new guidance will prompt earlier

responses by management and directors which may mitigate adverse effects, deterring NOCLAR from occurring and timelier intervention by public authorities.

The changes to the auditing standard aligned definitions and reminds auditors that they may have responsibilities under their applicable ethical requirements.

ISA 250 (Revised) will be effective for audits of financial statements for periods beginning on or after December 15, 2017. Group members may wish to familiarise themselves with the NOCLAR Code of Ethics – whilst this currently sits at the international code of conduct-level we anticipate it may be implemented in the UK in future. The IESBA NOCLAR standard comes into effect 15 July 2017.

Autumn developments in audit

PwC's Diana Hillier summarises two recent assurance events – the 10 year anniversary of the IFIAR and the recent PIOB Roundtable.

10 years of driving audit quality around the world

September 2016 marked the 10 year anniversary of the International Forum of Independent Audit Regulators (IFIAR). Established in Paris in 2006 by independent audit regulators from 18 jurisdictions, IFIAR now has 52 members around the world.

IFIAR was created to serve the public interest and to enhance investor protection by improving audit quality globally. Since 2006 it's focused on sharing knowledge of the audit market environment and the practical experience of independent audit regulatory activity, promoting collaboration and consistency in regulatory activity, and providing a platform for dialogue with other international organisations interested in audit quality. IFIAR has grown to become the leading international organisation in auditing matters.

To help identify audit quality trends, IFIAR conducts an annual Inspection Findings Survey which informs IFIAR's collective efforts to promote audit quality globally, complementary to individual regulators' audit firm inspection and oversight regimes, the results of which are made public every year.

Group members may wish to familiarise themselves with this year's survey, the results of which can be found here. They will also want to keep an eye out for future IFIAR releases.

PIOB 2nd Public Interest workshop

The Public Interest Oversight Board (PIOB) is the global independent oversight body for the IFAC audit, ethics and educations standard setting boards – standards which inform the standard setters in the UK. The PIOB provides independent oversight throughout the entire process of standard setting to help ensure that standards development is fully responsive to stakeholder needs, accountable and transparent.

In September, the Public Interest Oversight Board (PIOB) held a workshop in New York: "Preparing for the next generation of auditors". 60 participants discussed a number of issues in 6 roundtables around three main themes: trends in audit, auditor independence and standard setting in the public interest. Below I've briefly summarised what was discussed at each roundtable.

Trends in audit

This session discussed the "expectations gap", the difference between the expectations of the general public of the audit and what the audit can actually deliver. The session was positive, reflecting on current trends which could help narrow this gap in future.

IT developments such as big data and data analytics are increasingly reducing effort spent on the routine aspects of the audit, freeing up time for the auditor to focus on issues that require professional judgement.

Participants agreed that auditor skills have evolved but would also need further development, and that the current education model is no longer adequate. Future auditors will need to develop data analytics skills, IT, valuation risk assessment and auditor's critical thinking. Audit teams also need a range of different skills — too much emphasis on developing data analytics skills over ethics and auditor behaviour was highlighted as a risk.

There was also agreement that forward-looking information was an area for future focus. Audit already incorporates forward-looking aspects, but it was agreed that auditors could do more in relation to other forward-looking information companies report. Assurance cannot eliminate inherent uncertainty, but assurance on the process of developing forward-looking information could be better. Greater involvement of auditors in forward-looking aspects of company's reporting would be beneficial for investors, but auditors may need additional legal protection to make this practical.

There was also agreement that anything less than a "positive" assurance will make assurance lose its value (for example, using a "negative" assurance "nothing came to my attention" rather than "in my opinion"). How the auditor communicates positive assurance is very important given that this level of assurance is not a guarantee, particularly in relation to forward-looking information, and should not be interpreted as such.

Big data and technological advances make positive assurance more probable, more tenable, and perhaps more defensible because it allows auditors to test bigger populations of data. However, professional judgement is still required and skills to use and mine the big data appropriately are essential. The auditor will still need to apply professional scepticism in challenging the assumptions made by management.

Auditor independence

Participants felt that conflict of interests can arise when audit firms provide non-audit services to audit clients. However, there were also views expressed against total separation and in support of multidisciplinary firms. In addition to risks to the independence of the auditor, there is a risk that audit firms' investment in audit quality may diminish over time, given the lower profitability of audit in relation to other non-assurance services. On the other hand, views were expressed that audit-only firms would fail to acquire knowledge needed to improve the ability of the firm to perform good quality audits, may face a loss of access to experts in areas related to the audit, and lose internal skill-development opportunities.

Participants suggested audit firms need to be more transparent about their business model. There is a wide perception that the level of transparency of the firms is low. Better governance could be an important safeguard against the risks to independence in audit firms' current business models. There are some good practices at national

levels (including the UK) but audit firms' "Transparency Reports" at the global level do not deal adequately with these issues. Better quality metrics and quality control measures would be welcomed. The question was asked whether the work of IFIAR could assist with this.

Some participants stated that audit firm rotation may have created competition on fees instead of competition on quality between firms. The Audit Committee should play its role in selecting the audit firm, yet many companies do not have audit committees.

Standard setting in the public interest and the PIOB

Standard-setting in the public interest needs the right balance between due process, regulation, and oversight. There was a widely held view that standard setting boards (SSBs) take the public interest into account and are able to respond and reconcile different interests, notwithstanding the existing tensions. The public interest is incorporated into the standard setting process – e.g.; selection of members; oversight of due process, role and make-up of the Consultative Advisory Groups (CAGs), range of people involved, and efforts to consider all perspectives. The PIOB is seen to have a strong coordination role between the different constituents and to facilitate openness and good communication between stakeholders, which is key for the functioning of the standards setting system. It was recognised, however, that the public interest evolves continuously and so continuous review of the process is important. There were suggestions that SSBs should act more strategically and devote more time to strategic standard setting and public interest matters instead of looking into details of standards. Standards need to be timely and relevant, and there is room for improvement.

The Monitoring Group of international financial institutions and regulatory bodies, including IFIAR, is currently undertaking a strategic review of the IFAC standard setting model and is likely to consult on proposed enhancements in 2017.

Group members who wish to familiarise themselves with the full summary of what was discussed can do so here. We'd advise that members watch for the proposed enhancements coming out of the Monitoring Group review next year. As the international standards inform UK standard setting, the robustness of the international standard setting model is important.

Investor engagement

Investor Forum publishes its Collective Engagement Framework

Shareholders in UK companies are increasing their engagement with companies through the Investor Forum. PwC's Hilary Eastman looks at what companies may want to do to make sure they are prepared.

In October the Investor Forum celebrated its two-year anniversary and launched its Collective Engagement Framework, designed to help prevent any potential violation of legal and regulatory requirements that could result from investors (in the UK and from abroad) acting together to engage with companies.

The Investor Forum, which was formed as a result of the Kay Review of UK equity markets and long-term decision-making, was officially launched in October 2014 to promote long-term investment in UK companies by supporting investors in their engagement activities. Since inception, they have engaged collectively with nine companies with an average engagement including 11 investors. But until August this year, the Investor Forum's engagement activities were not known to those outside their discussions. That changed when they publicly criticised Sports Direct, asking the company to dismiss its chairman, overhaul the board and conduct a review of its governance policies and procedures.

The Collective Engagement Framework covers legal, operating and governance matters that arise from engagement activities and aims to protect Forum members (now 41 of them) by taking into account the need to safeguard against:

- the dissemination or creation of inside information, inadvertently or otherwise
- the creation of concert parties or triggering of group filing requirements
- potentially exercising a controlling influence over a company.

So what can companies expect?

Firstly, if there is no critical mass of shareholder support, the Investor Forum will not proceed with engagement. But if there is widespread concern about something the company is (or indeed isn't) doing, board members can expect the following:

- The engagement will focus on value creation, not box ticking, and will seek to be constructive rather than simply being critical.
- The engagement strategy will be agreed with the investor participants before it moves forward.
- The Investor Forum will seek up-to-date views from investor participants throughout the process to ensure that engagement only proceeds as long as investors still have concerns.
- There is no intention for the Investor Forum's activities to supersede direct engagement between companies and their shareholders.
- All dialogue is confidential but may become public only when it is felt necessary and if agreed with participants (such as the Sports Direct case).

Ultimately, the Investor Forum seeks to be proactive in building relationships with CEOs and boards so that the dialogue can be as constructive and effective as possible. The Investor Forum will publish its first annual review in January 2017. The review will include case studies covering different engagement situations and outcomes.

A summary of the Collective Engagement Framework is available here.

Group members should think about what matters to your shareholders and what they might want to engage with you on. Is the board or the investor relations team getting questions on particular matters? This might give a clue about concerns that could lead to engagement opportunities and it would be useful to think about how you would explain the situation or issue to your shareholders - before you get a call about it.

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